

EXECUTIVE SECRETARIAT ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI		X		
2	DDCI		X		
3	EXDIR		X		
4	D/ICS				
5	DDI	X			
6	DDA				
7	DDO				
8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/Pers				
14	D/OLL				
15	D/PAO				
16	SA/IA				
17	AO/DCI				
18	C/IPD/OIS				
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SUSPENSE 14 September
Date

Remarks

Please prepare a response for the
DCI's signature.

D/ Executive Secretary
10 September 1984
Date

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THE WHITE HOUSE

WASHINGTON

September 10, 1984

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Executive Registry

84-6135

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MEMORANDUM FOR THE HONORABLE WILLIAM J. CASEY
The Director of Central Intelligence

SUBJECT: Soviet Energy Development and Its Strategic
Implications for East-West Relations

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Background

The Soviet Ministry of Foreign Affairs has voiced its intention to discuss U.S. export controls on energy equipment during the U.S.-Soviet economic working group meetings to be held under the Long-Term Agreement to Facilitate Economic, Industrial and Technical cooperation tentatively scheduled for November 1984 in Moscow. Because of the importance of this issue in the context of our overall U.S. foreign policy objectives, I believe it would be imprudent for the Administration to undertake any such discussions without an up-to-date assessment of Soviet energy policy goals and the role of Western equipment and technology in achieving these goals. Past work by the Agency on Soviet energy developments and their implications for East-West relations has contributed significantly toward the advancement of U.S. policy formulation. For this reason, I am requesting that you revisit this issue so we may be prepared to consider whether or not any adjustments to our present policies in this area may be required.

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Nature of the Problem

Over the past few years, we have seen several disturbing instances where the Soviets have sought to gain important political and economic leverage over the West through the use of energy exports. The Soviets are:

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- o Using energy sales to the West as the centerpiece of their hard currency earnings structure. Today oil and gas sales account for about 66% of total annual Soviet hard currency earnings.
- o Seeking an increasingly dominant share of European gas markets through predatory pricing practices. The Soviets probably hope to capture as much as 50-60% of Europe's total gas demand over the next two decades, resulting in additional crucial hard currency earnings of as much as \$10 billion or more. (Rough estimates based on a fully subscribed first strand of pipeline, use of other existing pipeline capacity and a fully subscribed new second strand of the Siberian pipeline).

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- o Seeking to expand their development of oil and gas resources off of Sakhalin Island jointly with the Japanese (SODECO) possibly at the expense of future U.S. LNG sales to Japan. We also have reports that they will also be selling up to 5 million tons of metallurgical coal to Japan with initial shipments beginning this year. 25X1
 - o Legally and illegally acquiring sophisticated Western oil and gas equipment, some of which is militarily useful, by leveraging future Soviet orders for energy-related equipment. 25X1
 - o Using the lure of energy equipment sales to also obtain preferential terms on credits. Much of Western sales of equipment for the Siberian pipeline project was financed with subsidized loans. 25X1
 - o Using pricing policy on gas sales to the West and the threat of cancellation of contracts to extort greater cooperation on the part of at least one West European government to cooperate in resisting U.S. and/or COCOM controls on strategic technologies. For example, a recent report reveals that the Soviets have told the Austrians that if they continue to cooperate with the West in restricting sensitive technology, they will double the price of their gas exports (Austria is about 80-90% dependent on Soviet gas supplies for its total gas requirements) and arrange for the cancellation of two construction contracts for projects in Eastern Europe totalling eight billion schillings. 25X1
- The Soviets will continue to pursue expanded energy exports to the West as a central component of their long term economic and geopolitical gameplan. In most instances, the Soviets will have the economic/commercial advantage and the ability to undercut alternatives through predatory pricing practices and the prospect of increased Western equipment sales and employment. The U.S., therefore, must continue to counter this Soviet policy with an on-going strategy building upon the President's major achievements in East-West economic relations over the past two and a half years. U.S. initiatives should continue to focus on: 25X1
- o Encouraging viable alternatives to Soviet gas in West European markets even if a "security premium" is embodied in higher prices. 25X1
 - o Limiting oil and gas equipment and technology transfers which give the Soviet's additional advantage/leverage in the development of their energy resources and increased sales to Western Europe and Japan. 25X1
 - o Monitoring the projected level of hard currency earnings derived from energy sales to the West and its impact on the Soviet ability to sustain its present global commitments. 25X1
 - o Assessing the degree to which Western sales of oil and gas equipment to the Soviets are best balanced against common Western security interests. 25X1

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- o Limiting Soviet efforts to expand energy sales in the Pacific Basin countries particularly Japan (Sakhalin project) at the potential expense of expanded U.S. LNG sales in the next decade. 25X1
- o Monitoring Soviet energy assistance and export to Eastern Europe and other Soviet surrogates such as Nicaragua and the prospect of sustaining this level of assistance in the future. 25X1
- o Analyzing the extent to which the Soviets would seek resources outside its borders (i.e. intervene in Iran), if the ability to exploit domestic reserves were, for any reason, sharply diminished. 25X1

Suggested Terms of Reference

To better position the U.S. to curtail the Soviet strategy of using energy sales as a geo-political weapon, major hard currency earner and lever for the acquisition of sensitive and sophisticated Western equipment and technology, a major effort is required to update past assessments on: 25X1

- o Soviet Energy Prospects: This aspect of the study should concentrate on the role of Western equipment and technology in the Soviet effort to develop its energy resource base. The impact of the denial of Western/U.S. equipment and technology should be assessed with particular reference to the approximately twenty-two items originally proposed to COCOM for multilateral controls. This section should also include a review of the equipment and technology most vital to Soviet development efforts, potential military applications of such items (i.e. single-crystal turbine blade technology), and the possibility of establishing controls on the export of such equipment in cooperation with our allies. In addition, the study should attempt to assess Soviet capabilities to develop indigenous manufacturing capacity in these critical areas and assess the impact on the efficiency of the use of Soviet equipment. 25X1
- o Soviet Strategy to Maximize Energy Exports, Advance Soviet Geo-political Objectives and as a Hard Currency Earner: This aspect of the study should examine Moscow's strategy for export maximization. It should begin with an estimate of future Soviet hard currency requirements and the role of oil and gas exports in achieving these targets. The impact of Soviet barter arrangements with OPEC nations should be examined. Soviet tactics to enlarge energy exports to Europe and the Pacific Basin nations should also be reviewed. Finally, the role of Soviet energy exports in maintaining relations with client states should be assessed. 25X1
- o Western Markets for Soviet Energy Sales: The energy outlook for Europe and the Pacific Basin should be examined, with an emphasis on likely efforts by the Soviets to further penetrate these markets. Potential alternatives to Soviet imports and

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the costs of developing these resources should be reviewed. In addition, European and Pacific Basin country attitudes toward greater dependence on the Soviet Union should be covered in the study, as well as the potential for U.S. exports to compete with and replace Soviet energy exports. U.S. policy options to minimize Soviet sales to key U.S. allies should also be presented for consideration. ☐ 25X1

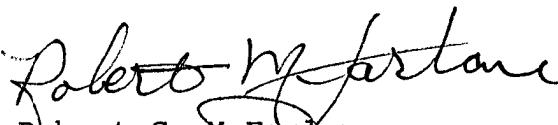
- o European/Japanese Perceptions of Soviet Energy Trade: The true economic benefit to Europe and Japan should be assessed, particularly the effects on Western employment (particularly the FRG), utilization of underused heavy industrial capacity and the indirect subsidization of uncompetitive Western companies for political purposes. In addition, Soviet disinformation themes should be catalogued which are designed to persuade Europe that, for example, the Soviets do not urgently need energy trade with the West and that the rationale behind U.S. efforts to restrict dual use energy equipment and place limits on Soviet sales to the West is really only a device to secure a preferred position for U.S. energy equipment suppliers. ☐ 25X1

The time horizon for the studies should be for the period of 1985-2000. ☐ 25X1

During the coming year we will be having extensive consultations with our Allies, bilaterally and within such fora as the IEA, OECD, COCOM and NATO, and therefore timely submission of this comprehensive update would be helpful. The Agency has been very responsive to our need in this area in the past and we know that you do have an accumulation of material which could be used for this assessment. However, given the overall importance of this exercise and the long term nature of the problem, we do not wish to set an unreasonable deadline. ☐ 25X1

I suggest that Roger Robinson, Bill Martin and David Wigg of my staff meet with members of OGI, SOVA, EURA to determine reasonable deadlines and to further discuss the nature of this study. ☐ 25X1

FOR THE PRESIDENT:


Robert C. McFarlane

cc: The Secretary of State
The Secretary of Commerce

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